Annual Treasury Management Review
2014/15

Contents

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Purpose

This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2014/15. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

During 2014/15 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 06/03/2014)
- a mid-year (minimum) treasury update report (Council 16/10/2014)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit and Governance Committee before they were reported to the full Council. Member training on treasury management issues was undertaken during the year on 22/02/2015 in order to support members' scrutiny role.

Executive Summary

During 2014/15, the Council complied with its legislative and regulatory requirements. The key prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Prudential and treasury indicators	2013/14 Actual	2014/15 Estimate	2014/15 Actual
Capital Expenditure	£000	£000	£000
Adult and Social Care	965	597	550
Schools Programme	37,457	53,977	44,889
Regeneration & Growth	33,384	24,097	29,123
Housing General fund	1,761	1,197	1,351
Residents First	1,307	819	635
Corporate Priorities	3,806	1070	3,842
Total Non - HRA	78,680	81,757	80,390
HRA	25,916	26,031	23,533
Total Capital Programme	104,596	107,788	103,923
Capital Financing Requirement:			
• Non-HRA	175,929	232,578	168,620
• HRA *(if applicable)*	180,479	188,310	181,287
• Total	356,408	420,888	349,907
External Debt	254,234	250,707	255,715
Finance Leases	65,243	62,361	62,361
Gross Debt	319,477	313,068	318,076
Investments			
• Longer than 1 year	(10,000)	(10,000)	(20,000)
• Under 1 year	(133,731)	(36.430)	(137,946)
• Total	(143,731)	(46,430)	(157,946)
Net borrowing	175,746	266,638	160,130

Other prudential and treasury indicators are to be found in the main body of this report. The Director of Finance also confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit (the authorised limit) was not breached.

The financial year 2014/15 continued the challenging investment environment of previous years, namely low investment returns.

Introduction and Background

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives

This report summarises the following:-

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- The actual prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Detailed debt activity; and
- Detailed investment activity.

1. The Council's Capital Expenditure and Financing 2014/15

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

General Fund	2013/14 Actual £000	2014/15 Estimate £000	2014/15 Actual £000
Capital expenditure	**78,680**	**81,757**	**80,390**
Capital Receipts	-	(13,182)	(7,128)
Capital Grants & Reserves	(83,846)	(49,413)	(71,773)
Revenue	(13,219)	(894)	(1,489)
Unfinanced capital expenditure	**-**	**(18,268)**	**-**

HRA	2013/14 Actual £000	2014/15 Estimate £000	2014/15 Actual £000
Capital expenditure	**25,916**	26,031	**23,533**
Financed in year	(18,385)	(21,276)	(20,107)
Unfinanced capital expenditure	**(7,531)**	**(4,755)**	**(3,426)**

2. The Council's Overall Borrowing Need

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2014/15 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

Reducing the CFR – the Council's (non HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. This is effectively a repayment of the non-Housing Revenue Account (HRA) borrowing need (there is no statutory requirement to reduce the HRA CFR). This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

The Council's 2014/15 MRP Policy (as required by CLG Guidance) was approved as part of the Treasury Management Strategy Report for 2014/15 on 06/03/2014.

The Council's CFR for the year is shown below, and represents a key prudential indicator. It includes PFI and leasing schemes on the balance sheet, which increase the Council's borrowing need. No borrowing is actually required against these schemes as a borrowing facility is included in the contract (if applicable).

CFR: General Fund	31 March 2014 Actual £000	31 March 2015 Budget £000	31 March 2015 Actual £000
Opening balance	203,619	223,562	175,929
Add unfinanced capital expenditure (as above)	-	18,268	-
Less MRP/VRP*	(25,188)	(6,388)	(4,445)
Less PFI & finance lease repayments	(2,502)	(2,864)	(2,864)
Closing balance	**175,929**	**232,578**	**168,620**

CFR : HRA	31 March 2014 Actual £000	31 March 2015 Budget £000	31 March 2015 Actual £000
Opening balance	175,841	183,555	180,479
Add unfinanced capital expenditure (as above)	7,531	4,755	3,426
Less VRP*	(2,893)	-	(2,618)
Less PFI & finance lease repayments	-	-	-
Closing balance	**180,479**	**188,310**	**181,287**

** Includes voluntary application of capital receipts*

Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2014/15) plus the estimates of any additional capital financing requirement for the current (2015/16) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2014/15. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

GENERAL FUND	31 March 2014 Actual £000	31 March 2015 Budget £000	31 March 2015 Actual £000
Gross borrowing position	158,585	154,427	159,428
CFR	175,929	232,578	168,620

HRA	31 March 2014 Actual £000	31 March 2015 Budget £000	31 March 2015 Actual £000
Gross borrowing position	160,874	158,641	158,648
CFR	180,479	188,310	181,287

The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2014/15 the Council has maintained gross borrowing within its authorised limit.

The operational boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

GENERAL FUND	2014/15 £000
Authorised limit	242,578
Maximum gross borrowing position	159,428
Operational boundary	232,578
Average gross borrowing position	155,787
Financing costs as a proportion of net revenue stream	3.51%

HRA	2014/15 £000
Authorised limit	193,552
Maximum gross borrowing position	160,861
Operational boundary	193,552
Average gross borrowing position	160,266
Financing costs as a proportion of net revenue stream	15.51%

3. Treasury Position as at 31 March 2015

The Council's debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the end of 2014/15 the Council's treasury (excluding borrowing by PFI and finance leases) position was as follows:

TABLE 1	31 March 2014 Principal £000	Rate/ Return	Average Life yrs.	31 March 2015 Principal £000	Rate/ Return	Average Life	
Fixed rate borrowing:							
-PWLB	208,843	4.79%	17.5	205,345	4.81%	17.2	
-Market	45,391	4.82%	52.2	50,369	4.38%	51.2	
Total debt	**254,234**	**4.79%**		**255,715**	**4.72%**		
CFR*	**291,183**			**287,546**			
Over / (under) borrowing	**(36,949)**			**(31,831)**			
Investments:							
- in house	143,731	0.66%	0.8	157,946	0.89	0.8	
- with managers	N/a						
Total investments	**143,731**	**0.66%**	**0.8**	**157,946**	**0.89**	**0.8**	

The maturity structure of the debt portfolio was as follows:

	31 March 2014 Actual £000	2014/15 original limits £000	31 March 2015 Actual £000
Under 12 months*	3,519	323	5,324
12 months and within 24 months	324	324	324
24 months and within 5 years	13,503	16,592	16,592
5 years and within 10 years	13,888	20,238	20,238
10 years and within 20 years	48,479	42,128	42,128
20 years and within 30 years	40,951	37,776	37,776
30 years and within 40 years	23,552	44,731	44,731
40 years and over 50 years	110,018	88,602	88,602

**includes 5.0m temporary loan*

The maturity structure of the investment portfolio was as follows:

	2013/14 Actual £000	2014/15 Estimate £000	2014/15 Actual £000
Investments			
Longer than 1 year	10,000	10,000	20,000
Under 1 year	133,731	36,430	137,946
Total	143,731	46,430	157,946

4. The Strategy for 2014/15

The expectation for interest rates within the strategy for 2014/15 anticipated low but rising Bank Rate (starting in quarter 1 of 2015), and gradual rises in medium and longer term fixed borrowing rates during 2014/15. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

The main rating agencies, Fitch, Moody's and Standard and Poor's removed the implied Government support they use in assessing financial institutions. As a result of these changes the council changed its counterparty selection criteria to rely on the short and long term ratings in its assessment of financial institutions.

During the year Council agreed to prepay up to two years of pension contributions equivalent to £33.0m (actual transaction in 2015/16).

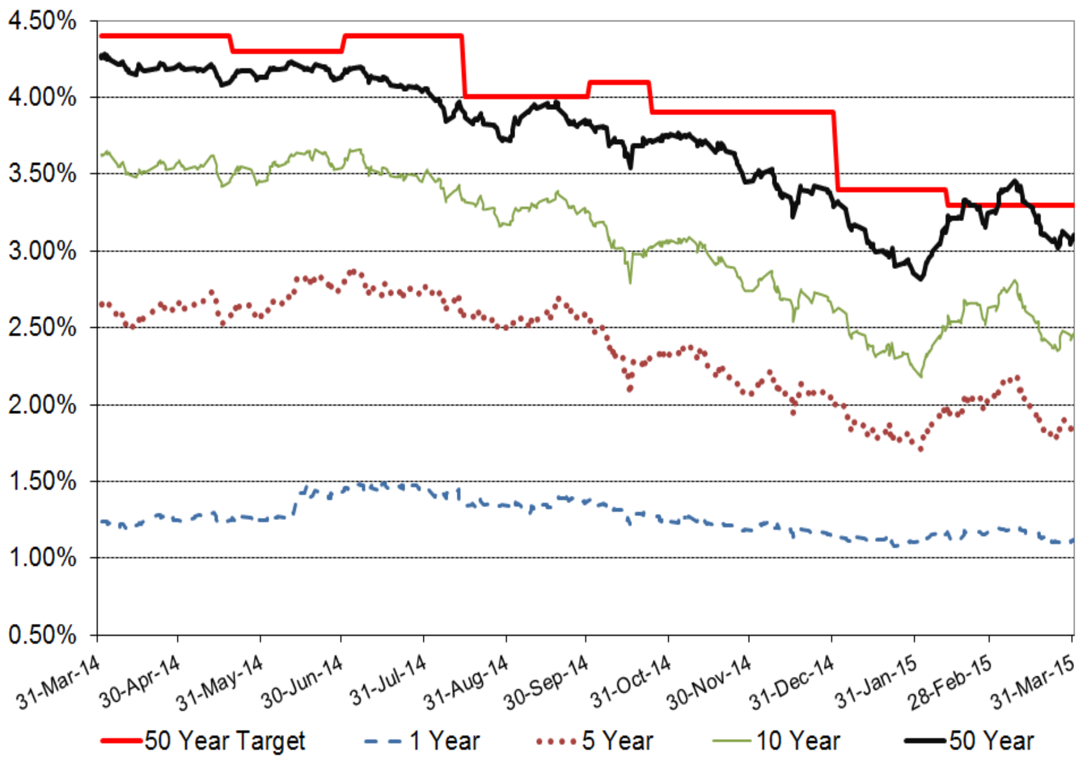
5. The Economy and Interest Rates

The original market expectation at the beginning of 2014/15 was for the first increase in Bank Rate to occur in quarter 1 2015 as the unemployment rate had fallen much faster than expected through the Bank of England's initial forward guidance target of 7%. In May, however, the Bank revised its forward guidance. A combination of very weak pay rises and inflation above the rate of pay rises meant that consumer disposable income was still being eroded and in August the Bank halved its forecast for pay inflation in 2014 from 2.5% to 1.25%. Expectations for the first increase in Bank Rate therefore started to recede as growth was still heavily dependent on buoyant consumer demand. During the second half of 2014 financial markets were caught out by a halving of the oil price and the collapse of the peg between the Swiss franc and the euro. Fears also increased considerably that the ECB was going to do too little too late to ward off the threat of deflation and recession in the Eurozone. In mid-October, financial markets had a major panic for about a week. By the end of 2014, it was clear that inflation in the UK was going to head towards zero in 2015 and possibly even turn negative. In turn, this made it clear that the MPC would have great difficulty in starting to raise Bank Rate in 2015 while inflation was around zero and so market expectations for the first increase receded back to around quarter 3 of 2016.

Gilt yields were on a falling trend for much of the last eight months of 2014/15 but were then pulled in different directions by increasing fears after the anti-austerity parties won power in Greece in January; developments since then have increased fears that Greece could be heading for an exit from the euro. While the direct effects of this would be manageable by the EU and ECB, it is very hard to quantify quite what the potential knock on effects would be on other countries in the Eurozone once the so called impossibility of a country leaving the EZ had been disproved. Another downward pressure on gilt yields was the announcement in January that the ECB would start a major programme of quantitative easing, purchasing EZ government and other debt in March. On the other hand, strong growth in the US caused an increase in confidence that the US was well on the way to making a full recovery from the financial crash and would be the first country to start increasing its central rate, probably by the end of 2015. The UK could be closely following it due to strong growth over both 2013 and 2014 and good prospects for a continuation into 2015 and beyond

6. Borrowing Rates in 2014/15

PWLB certainty maturity borrowing rates (Preferential Rates for Local Authorities) - the graphs and table for PWLB rates below, show, for a selection of maturity periods, the average borrowing rates, the high and low points in rates, spreads and individual rates at the start and the end of the financial year.



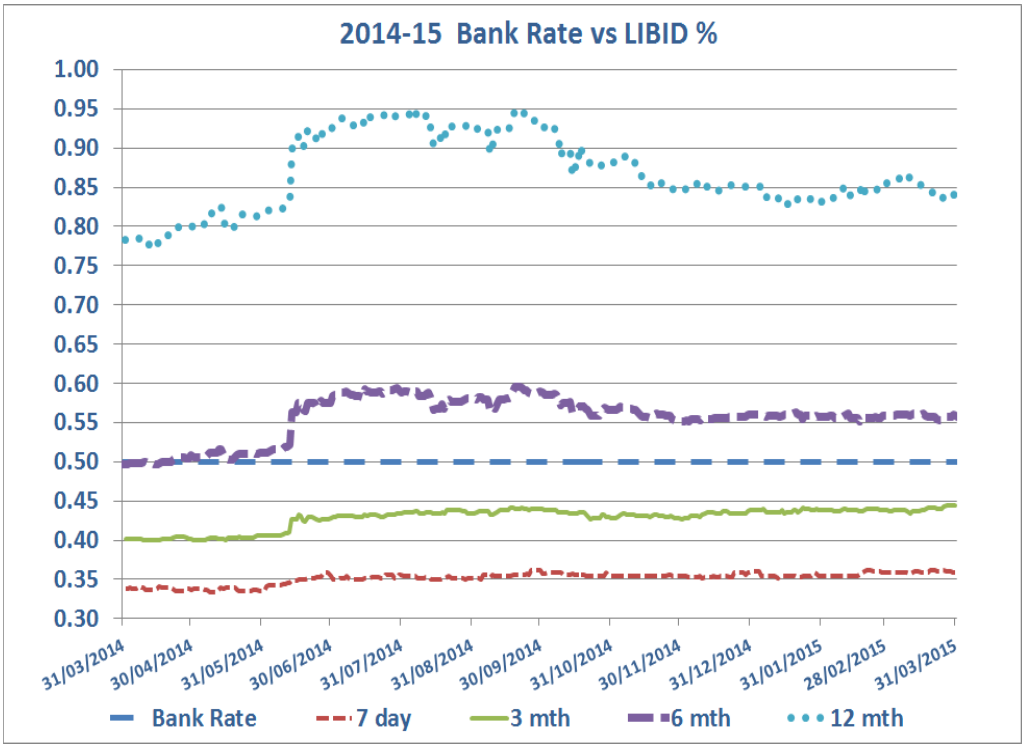
7. Borrowing Outturn for 2014/15

Treasury Borrowing

Borrowing - – The council's external debt as at 31/03/2015 was £255.7m. There were no new long term loans drawn in 2014/15, temporary loans drawn in year was £10.0m. The Council repaid loans of £3,519k in long term loans and 5.0m in temporary loans in the year. No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

8. Investment Rates in 2014/15

Bank Rate remained at its historic low of 0.5% throughout the year; it has now remained unchanged for six years. Market expectations as to the timing of the start of monetary tightening started the year at quarter 1 2015 but then moved back to around quarter 3 2016 by the end of the year. Deposit rates remained depressed during the whole of the year, primarily due to the effects of the Funding for Lending Scheme.



9. Investment Outturn for 2014/15

Investment Policy – the Council's investment policy is governed by CLG guidance, which has been implemented in the annual investment strategy approved by the Council on 06/03/2014. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties. Council agreed in the mid-year 2014/15 to prepay pension contributions which would be undertaken in the ensuing year 2015/16.

Resources – the Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised as follows:

Balance Sheet Resources: General fund	31 March 2014 £000	31 March 2015 £000
Capital receipts	**8,929**	**18,231**
Unapplied Capital Grants	**49,675**	**31,415**
Earmarked Reserves	**66,199**	**68,916**
Grant Reserves	**4,726**	**7,480**
Provisions	**5,699**	**6,256**
General fund Balance	**15,729**	**16,238**
Total	**150,957**	**148,536**

Balance Sheet Resources: HRA	**31 March 2014 £000**	**31 March 2015 £000**
Earmarked Reserves	**4,690**	**5,380**
HRA Balance	**3,283**	**3,915**
Total	**7,973**	**9,295**

Investments held by the Council - the Council maintained an average balance of £169.5m of internally managed funds. The internally managed funds generated interest of £1.2m equivalent to an average rate of 0.71%. The comparable performance indicator is the average 6mth LIBID rate, which was 0.68%. This compares with a budget assumption of £46.4m investment balances earning an average rate of 0.60%.